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**OFFICE OF INSPECTOR GENERAL**  
for the Millennium Challenge Corporation

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**RISK ASSESSMENT OF  
MILLENNIUM CHALLENGE  
ACCOUNT VANUATU'S  
FINANCIAL OPERATIONS**

REPORT NO. M-000-07-003-F  
January 11, 2007

WASHINGTON, DC



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FROM THE AMERICAN PEOPLE

*Office of Inspector General  
for the  
Millennium Challenge Corporation*

January 11, 2007

The Honorable John J. Danilovich  
Chief Executive Officer  
Millennium Challenge Corporation  
875 15<sup>TH</sup> Street, NW  
Washington, DC 20005-2203

Dear Mr. Ambassador:

This letter transmits our final report on the Risk Assessment of Millennium Challenge Account Vanuatu's Financial Operations. In finalizing the report, we considered your written comments on our draft report and included those comments in their entirety in Appendix II of this report.

The report contains no audit recommendations for corrective action.

I appreciate the cooperation and courtesy extended to my staff during the audit.

Sincerely,

/s/

John M. Phee  
Assistant Inspector General  
Millennium Challenge Corporation

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# BACKGROUND

On March 2, 2006, the United States of America, acting through the Millennium Challenge Corporation (MCC), signed a Compact Agreement with the Government of Vanuatu to provide a grant of approximately \$65.7 million. The Compact “entered-into-force” on April 28, 2006.

The five-year Compact program addresses the country's poor transportation infrastructure. Consisting of eleven infrastructure projects—including roads, wharfs, an airstrip and warehouses—the program aims to benefit poor, rural agricultural producers and providers of tourist related goods and services by reducing transportation costs and improving the reliability of access to transportation services.

The goal of the Compact is to have a transformative impact on Vanuatu's economic development by increasing average income per capita by 15 percent within 5 years and directly impacting the lives of more than 65,000 poor, rural inhabitants—almost a third of the entire population.

Millennium Challenge Account (MCA) Vanuatu's program consists of two principal components:

- 1) Civil works for the reconstruction of priority transport infrastructure on eight islands, covering roads, wharfs, an airstrip, and warehouses; and
- 2) Institutional strengthening efforts and policy reform initiatives in Vanuatu's Public Works Department, including: provision of plant and equipment for maintenance; introduction of service performance contracts; establishment of local community maintenance schemes; and introduction of user fees. These efforts aim to ensure the sustainable operation and maintenance of Vanuatu's entire transport infrastructure network, not only those assets built or rehabilitated with MCC funds.

The Compact also includes approximately \$5.0 million for Program administration, oversight, and Monitoring and Evaluation.

MCA Vanuatu is responsible for the oversight and management of the MCC Compact. At the time of our assessment, MCA Vanuatu had established its operational structure consisting of the following.

- A steering committee to oversee MCA Vanuatu's responsibilities and obligations under the Compact. The Steering Committee is comprised of both government and non-governmental stakeholders.
- A Program Management Unit that is responsible for day-to-day management responsibilities for implementation of the Compact. The management team will ultimately be composed of the following members: Managing Director, Economist, Engineer, Environmental and Social Impact officer and one Support Staff.

## **ASSESSMENT OBJECTIVES**

The Office of Inspector General performed a risk assessment of critical areas in MCA Vanuatu's financial operations to identify vulnerabilities that could adversely impact MCA Vanuatu's operations; we determined that the most critical areas are cash management and procurement. Therefore, our risk assessment was designed to identify and evaluate vulnerabilities in those areas.

# **DISCUSSION**

During our site visit we observed that MCA Vanuatu had established the Fiscal and Procurement Agents for the MCA program which is essential for MCA's establishment of accountability over MCA program funds; however, necessary information regarding MCA disbursements was not being received by MCA Vanuatu.

### **Cash Management**

We assessed the overall risk associated with MCA Vanuatu's cash management process as moderate. However, we determined that MCA Vanuatu could improve its process for managing its disbursements.

To manage the program's disbursements, MCA Vanuatu maintains an account with the Republic of Vanuatu's Reserve Bank. However, as of the time of our review in late August 2006 the MCA had made no disbursements from this account. The Government of Vanuatu paid for MCA expenses out of a General Fund and the MCA had not yet reimbursed the General Fund. The Director of MCA Vanuatu explained to us that expenses had been incurred on behalf of MCA Vanuatu and that he kept manual entries of expenses incurred. The Director explained that he had not received reports confirming his expenses from Vanuatu's Department of Finance which serves as the Fiscal Agent for MCA Vanuatu. However, a spokesperson for the Department of Finance commented that the MCA expense information was available to the Director through the existing electronic accounting system. The Director explained to us that he could not access the financial information regarding MCA Vanuatu's expenses because he had not received training on how to use the electronic accounting system. On the other hand, the spokesperson from the Ministry of Finance stated to us that he had thought that the Director did have staff with the knowledge on how to use the system. During our risk assessment, MCA Vanuatu sent to the Ministry of Finance a request for the needed training.

In addition, the MCC approved a total disbursement of \$1,574,624 for the period from the entry-into-force of the Compact April 28, 2006 to September 30, 2006. However, the MCC provided MCA Vanuatu tranches (payments) of the requested disbursement on a monthly basis. The monthly tranches are derived from the monthly estimates provided in the MCA Vanuatu Financial Plan. The first tranche included an additional \$500,000 for working capital. The \$500,000 amount provided was in addition to MCA Vanuatu's total estimate of

cash needs. This is in accordance with the MCC's policy of providing MCAs with \$500,000 above the MCAs' total estimate of their cash needs.

At the time of our site visit at the end of August 2006, MCA Vanuatu had in its separate MCA Account, \$1,350,504. Later we confirmed with MCC that, as of September 30, 2006 MCC had distributed to MCA Vanuatu \$1,575,000. Expenses incurred by MCA Vanuatu from entry-into-force April 28, 2006 to September 30, 2006 were \$104,035. We believe the difference<sup>1</sup> was in excess of the MCA's immediate cash needs. In accordance with the U.S. Department of Treasury guidelines, we believe that disbursements to MCAs should only be for MCAs' immediate cash needs. We are not making a recommendation in this report to address the MCC's policy related to disbursements discussed above because a recommendation was made by the OIG in its transmittal letter contained in the recent audit of MCC's financial statements<sup>2</sup> and also a similar recommendation was made by the OIG in its Report on the Risk Assessment of Millennium Challenge Account Cape Verde's Financial Operation.<sup>3</sup>

## **Procurement**

We assessed the risk associated with MCA Vanuatu's procurement processes as being moderate. Based on our assessment, we believe that MCA Vanuatu had established policies that complied with the procurement guidelines established by MCA Vanuatu and the MCC. However we did have concerns with the lack of communication between the Procurement Agent and the Director of MCA Vanuatu.

The Compact entered-into-force on April 28, 2006. A Procurement Agreement was signed with the BCEOM French Engineering Consultants and MCA Vanuatu on May 15, 2006. On June 15, 2006 an Interim Procurement Plan was put into place. On June 26, 2006 the Procurement Agent accepted responsibility for approving and implementing purchase order requisitions under \$50,000. During a site visit the week of June 26, 2006 through June 30, 2006, ten procurements under \$50,000 were reviewed by MCC staff and found by them to be in compliance with the Procurement Agreement.

Initially, the Procurement Agent did not understand and perform the full scope of his responsibilities in accordance with that agreed to by the MCA. This problem was due primarily to an oversight on part of MCA Vanuatu and the initial confusion of the Procurement Agent and MCA Vanuatu concerning the Procurement Agent's scope of responsibility for making small procurements.

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<sup>1</sup> The difference is calculated as \$1,350,504 minus \$104,035 equals \$1,246,469. This is the monetary difference between the cash provided to MCA (plus interest earned) and the expenses MCA incurred during the time period from April 28, 2006 through September 30, 2006.

<sup>2</sup> Audit Report No. M-000-07-001-F, Audit of the Millennium Challenge Corporation's Financial Statements, Internal Controls, and Compliance for the Period Ending September 30, 2006 and 2005. See Recommendation No. 2.

<sup>3</sup> Audit Report No. M-000-06-004-F, Risk Assessment of Millennium Challenge Account Cape Verde's Financial Operations. See Recommendation No. 1.

While ultimately it is the responsibility of MCA Vanuatu to ensure coordination, the MCC played a strong role in managing the conflict that arose between MCA Vanuatu and the Procurement Agent. Eventually, responsibilities of the Procurement Agent were resolved and communications between the two parties was greatly improved by the use of an independent consultant hired by the MCC.

## **CONCLUSION**

We assessed the overall risk associated with MCA Vanuatu's cash management and procurement processes as both being moderate.

## **RECOMMENDATIONS**

Our review did not disclose any findings for which previous recommendations had not been made; therefore, no recommendations are included herein.

# SCOPE AND METHODOLOGY

## Scope

The Office of Inspector General (OIG) performed a risk assessment of MCA Vanuatu financial operations. The purpose of the assessment was to evaluate and identify vulnerabilities in areas that may adversely impact MCA Vanuatu's financial operations. This was not an audit, and as such we did not apply all Government Auditing Standards procedures to identify all conditions that may adversely affect MCA Vanuatu's financial operations. The risk assessment was conducted at MCA Vanuatu in Port Vila, Vanuatu from August 25, 2006, to August 28, 2006. Following the assessment fieldwork performed in Vanuatu, the assessment team consulted with MCA Vanuatu and the MCC in Washington from September 3, 2006 to November 6, 2006.

## Methodology

To gain an understanding of MCA Vanuatu operation and controls, the OIG interviewed MCA Vanuatu staff, the Fiscal and Procurement Agents, the Auditor General of Vanuatu and the relevant MCC personnel in Washington, DC. The risk assessment focused on MCA Vanuatu's financial operations from April 28, 2006, to August 25, 2006. We assessed transactions, policies, controls and procedures in effect during this period. We judged risk exposure (i.e., the likelihood of significant abuse, illegal acts and/or misuse of resources; failure to achieve program objectives; and noncompliance with laws, regulations, and management policies) in the areas of cash management and procurement. Using this information, we assessed the level of risk (low, moderate, or high) for each of these key financial operations.

The general methodology for the risk assessment included the following:

- Interviews of key MCA Vanuatu personnel in each of the areas assessed;
- Reviews of the Compact agreement, sub-agreements and applicable laws and regulations;
- Reviews of current MCA Vanuatu policies, procedures and processes;
- Evaluations of transactions processed during the review period; and
- Considerations of the MCC's role in establishing and implementing MCA Vanuatu.

The risk assessment has the following limitations:

- Higher risk exposure assessments are not a definitive indicator that objectives are not being achieved or that irregularities are occurring. Rather, a higher risk exposure implies that the particular function is more vulnerable to adverse events.
- Because the assessments consider both internal and external factors, some of which are outside the span of control of management, risk exposure assessments, in isolation are not an indicator of management capability.





**MILLENNIUM  
CHALLENGE  
CORPORATION**  
REDUCING POVERTY THROUGH GROWTH

## MANAGEMENT COMMENTS

December 12, 2006

Mr. John M. Phee  
Assistant Inspector General  
Millennium Challenge Corporation  
1300 Pennsylvania Ave, NW  
Washington, DC 20523

Dear Mr. Phee:

With respect to the risk assessment of Millennium Challenge Account-Vanuatu financial operations report numbered M000-07-XXX-F, we appreciate the opportunity to provide to you our comments. As you point out, this review was not an audit, and therefore was not subject to specific or expansive procedures normally performed under audit conditions.

The report highlights specific areas of moderate vulnerability for financial operations. One such area was that the Vanuatu disbursement tranches exceeded the immediate cash needs. The second area discussed in the report was that reimbursement to the Vanuatu General Fund account was not occurring. MCC Fiscal Accountability is aware of both of these areas of concern and has worked closely with MCA-Vanuatu and the Fiscal Agent (the Ministry of Finance) to ensure that both situations are resolved. We will continue to monitor that the Fiscal Agent stays compliant with our guidelines.

The report also addresses MCA Vanuatu's procurement process and determined it carried a moderate risk level. The assessment found the Procurement Agent did not understand and perform the full scope of its responsibilities. It was further found that there appeared to be some communication difficulties between the Procurement Agent and MCA Vanuatu. While the communication with the Procurement Agent showed some improvement at the end of August, during the IG team visit, the situation further deteriorated and MCC terminated the Procurement Agent Agreement on November 14, 2006. MCA-Vanuatu is currently in the process of obtaining a new Procurement Agent.

Thank you for the opportunity to review and comment on the report. We look forward to working collaboratively on MCC issues in the future.

Sincerely yours,

/s/ Charles O. Sethness  
Vice President Accountability

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